BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal)
)
of)
)
THE TIMES-MIRROR COMPANY)

Appearances:

For Appellant: Mackay, McGregor, Reynolds & Bennion, Attorneys at Law

'For Respondent: Burl D. Lack, Chief Counsel; Hebard P. Smith, Associate Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code (formerly Section 25(c) of the Bank and Corporation Franchise Tax Act) from the action of the Franchise Tax Board on the protests of The Times-Mirror Company. to proposed assessments of additional franchise tax in the amounts of $6,431.82, $7,896.11 and $4,812.88 for the income years 1943, 1944 and 1945, respectively. Certain of the adjustments in the proposed assessments for the years 1944 and 1945 have not been protested by Appellant and are not questioned here.

Appellant is a California corporation engaged in the business of publishing a daily and Sunday newspaper in the City of Los Angeles, It receives its principal income from the circulation of its newspapers and from sales of advertising, During the years in question Appellant entered into annual written contracts with Williams, Lawrence & Cresmer Company, a corporation for the sale by that firm of national advertising, National advertising is advertising procured from large national concerns that advertise throughout the entire United States. We have not been furnished with copies of the annual contracts, nor with any information concerning the terms thereof, other than the fact that for its services Williams, Lawrence & Cresmer Company received a "minimum salary" of $35,000 per year, plus an additional fee based upon the procurement of national advertising above a specified minimum lineage,.

Williams, Lawrence & Cresmer Company maintained offices, in Chicago, Illinois, Detroit, Michigan, and New York City. It does not appear affirmatively that its business was limited to sales of advertising for Appellant but it represented no one else from the Los Angeles area. In its correspondence concerning the business of Appellant, Williams, Lawrence & Cresmer Company used the letterhead of the Los Angeles Times, on which was imprinted "Advertising Representatives - Williams, Lawrence & Cresmer," with the address of the Chicago or New York office. The Appellant's name appears on the building directories and the doors of the offices in Chicago and New York. Upon sales of national advertising by Williams, Lawrence & Cresmer Company through other advertising agencies, the Appellant paid to such agencies a commission of 15%, said to be the standard commission in the industry. Those commissions were in addition to the agreed compensation paid by Appellant to Williams, Lawrence & Cresmer Company.

Appellant's officers and employees called at the Chicago, Detroit and New York offices of Williams, Lawrence & Cresmer Company at least twice annually in connection with sales of national advertising. It does not, however, appear that such officers and employees personally solicited any sales. Asa part of its program to procure national advertising Appellant made large expenditures for promotional advertising in national publications. It also maintained at Los Angeles an extensive research department designed primarily to assist in the solicitation of national advertising,

In reporting its income for. each of the years in question Appellant, acting under Section 10 of the Bank and Corporation Franchise Tax Act, allocated its income to sources within and without California by the three-factor formula of property, payroll and sales. It included in the sales factor as out-of-state sales all sales of advertising made through Williams, Lawrence & Cresmer Company, Commissions and other compensation paid to that company and to other out-of-state advertising agencies were included in the payroll factor as out-of-state payroll.- The Franchise Tax Board reallocated Appellant's income, using the same formula but treating all sales of advertising as California sales and omitting from the payroll factor all commissions and. other compensation paid to Williams, Lawrence & Cresmer Company and other out-of-state advertising agencies.

In Irvine Co. v. McColgan, 26 Cal. (2d) 160 and El Dorado Oil Works v. McColgan, 34 Cal. (2) 731, it was held that sales outside California through independent brokers or selling agencies were not activities of the producing corporation in California and did not constitute doing business outside this State by the corporation within the meaning

of Section 10 of the Bank and Corporation Franchise Tax Act as it read for the years 1934 and 1935. Appellant seeks to distinguish those cases on the basis of the amendment of Section 10 (Stats. 1939, p. 2944), to provide that if income is derived from or attributable to sources both within and without the State the tax shall be measured by net income derived from or attributable to sources within this State. Before the amendment the tax had been measured by that portion of net income derived from business done in this State.

This argument overlooks the well recognized principle that the source of income is an activity or property. 8 Mertens, Law of Federal Income Taxation, p. 289. It is the situs of the activity or property which constitutes the source of income. British Timken Limited, 12'T.C. 880. In accord with this basic principle the amendment of 1939 provided that "Income derived from or attributable to sources within this State includes income from tangible or intangible property located or having a situs in this State and income from any activities carried on in this State, regardless of whether carried on in intrastate, interstate or foreign commerce." Thus, from the standpoint of the source of income, as well as that of doing business, the activity of Appellant is to be distinguished from activity on its behalf by independent agents without the State. The focal point to be considered, as in the Irvine and El Dorado Oil Works decisions, is the place where the activities of Appellant occurred which resulted in the sales,

During the years 1943, 1944 and 1945 Appellant did not have any sales offices outside of California. It had no employees outside the State who made sales. It does not contend? nor has it furnished any evidence to show, that Williams, Lawrence & Cresmer Company was more than an independent selling agent or broker. Appellant's only sales activity outside California, accordingly, consisted of the above-stated semi-annual visits of its officers and employees to the out-of-state offices of Williams, Lawrence & Cresmer Company.

Unquestionably the out-of-state activities of Appellant's officers and employees during their semi-annual, visits to the offices of Williams, Lawrence & Cresmer Company are reflected to some degree in Appellant's income. To the extent of the salaries paid to its officers and employees while outside the State allowance should, accordingly, be made in the payroll factor, The Franchise Tax Board has conceded that such an allowance is proper and has agreed to include such salaries in out-of-state payroll.

While it may be that the out-of-state activities of Appellant's officers and employees tended to increase sales of advertising on its behalf by Williams, Lawrence & Cresmer

Company, it does not appear that such officers and employees personally solicited any sales, or that any demonstrable portion of the sales of Williams, Lawrence & Cresmer Company resulted directly from such activities. Under such circumstances any adjustment in the formula to give consideration to such activities, other than in the payroll factor, is beyond the practical limitations of an apportionment formula. "Rough approximation rather than precision" in the formula allocation of income is sufficient. Illinois Central Railroad Co. v. Minnesota, 309 U. S. 157,161; International Harvester Co. v. Evatt, 329 u. s. 416; El Dorado Oil Works v. McColgan, supra.

Appellant relies on language in Pacific Fruit Express Co. v. McColgan, 67 Cal. App. (2d) 93, as authority for the inclusion in the out-of-state payroll factor of commissions and other compensation paid to the Williams, Lawrence & Cresmer Company and other out-of-state advertising agencies. In that decision the California District Court of Appeal stated that amounts paid to out-of-state contractors for making repairs to the taxpayer's railway cars, and for the cost of icing its refrigerator cars, should have been included in the out-of-state payroll factor. The Court, however, upheld the formula as applied by the Franchise Tax Commissioner. Its statement concerning an allowance in the formula on account of payments made out-of-state to an independent contractor is, accordingly, dictum. In the light of decisions of the California Supreme Court the reasoning of the District Court of Appeal is unsound as applied to amounts paid to out-of-state brokers and independent sales agencies. Irvine Co. v. McColgan, supra; El Dorado Oil Works v. McColgan, supra, we conclude, accordingly, that the Franchise Tax Board properly excluded from the payroll factor amounts paid by Appellant to Williams, Lawrence & Cresmer Company and other out-of-state advertising agencies.

Our conclusions herein make it unnecessary to discuss Appellant's contention that its expenditures for promotional advertising in national publications and the cost of maintaining its research department in Los Angeles should have been included in the out-of-state payroll factor. Upon the facts presented to us, we are of the opinion that the Franchise Tax Board's reallocation of Appellant's income was an honest effort to apportion to California that part of its income fairly attributable to sources within the State.

The second issue in this appeal concerns the partial disallowance of deductions claimed by Appellant, under Section 8(p) of the Bank and Corporation Franchise Tax Act, on account of contributions to its employee pension plan. For the income year 1945 Appellant claimed as a deduction the aggregate amount of $24,446.50 paid for benefits purchased for its employees returning from military service.

For each of the income years 1943, 1944 and 1945 it claimed a deduction in the amount of $57.25, representing the cost of similar benefits for employees of the Southwest Company, a wholly owned subsidiary, returning from military service. Further deductions for those years in the amounts of $546.12, $808.51 and $858.75, respectively, were claimed for current costs of benefits for employees of the Southwest Company.

Appellant has furnished us no information concerning the deductions claimed on account of employees of the Southwest Company. It contends, however, that the services of such employees inured to its benefit and hence the cost of covering them under the pension plan is deductible. The Franchise Tax Board has informed us that the Southwest Company was liquidated on December 31, 1945. Its income for the year 1945 was included in Appellant's income as a transferee pursuant to Section 13(h) of the Act. Prior to the year 1945 the Southwest Company filed its returns and paid its franchise tax as a separate corporation.

In recomputing Appellant's income the Franchise Tax Board allowed as a deduction only 10%, or $2,444.65, of the amount expended by Appellant for benefits purchased for its own employees returning from military service, on the ground that such expenditures were for past services and were required to be amortized over a ten year period. It disallowed in full the deductions claimed on account of the employees of the Southwest Company.

Section 8(p) of the Act, during the years in question, provided that contributions to a pension plan for employees were deductible only under that section and only if they would be deductible under Section 8(a) as a general business expense in the absence of Section 8(p). It also provided in effect that, in addition to the normal cost of the plan, 10 percent of the cost for "past service or other supplementary pension or annuity credits" was deductible annually over a 10 year period. These provisions were based on Section 23(p) of the federal Internal Revenue Code. The federal regulation (Reg. 111, Sec. 2923(p)-7) interpreting the language, states:

> "'Normal cost' for any year is the amount actuarially determined which would be required as a contribution by the employer in such year to maintain the plan if the plan had been in effect from the beginning of service of each then included employee and if such costs for prior years had been paid and all assumptions as to interest, mortality, time of payment, etc., had been fulfilled. Past service or supplementary cost at any time is the amount actuarially

determined which would be required at such time to meet all the future benefits provided under the plan which would not be met by future normal costs and employee contributions with respect to the employees covered under the plan at such time."

It is apparent that the additional contributions which Appellant made for its own returning employees were supplemental costs subject to the 10 per cent limitation as determined by the Franchise Tax Board, without the necessity of deciding they were for past services.

In regard to the deductions claimed on account of employees of the Southwest Company, it is sufficient to state that as a general rule one taxpayer cannot deduct for obligations of another, however closely related. (Interstate Transit Lines v. C.I.R., 319 U. S. 590; Esmond Mills v. C.I.R., 132 Fed 2d 753; Wade E. Moore..7 T.C. 1250. 1261; Coosa Land Company, 29 B.T.A. 38) Appellant has pointed to no special circumstance requiring a deviation from the rule.

A final issue involves the question whether the cost of microfilming Appellant's files of newspapers constitute@ an ordinary and necessary business expense, deductible in the year incurred, or a capital expenditure, recoverable over the period of the useful life of the film.

During the income years 1943 and 1944 Appellant deducted from income expenses of $40,000 and $44,179.04, respectively, incurred for micro-filming its file of newspapers from 1887 to a current date. The Franchise Tax Board determined that the micro-film constituted a capital asset and that the cost thereof should be amortized over a period of twenty-five years.

It is well established that the cost of property having a useful life of more than one year is a capital expenditure. This rule has been applied to the cost of micro-filming old newspaper files not classified as current records (I.T. 3732, C.B. 1945, p. 88) and to the cost of films for use in sales promotional activities (Archibald V. Simonson, T.C. Memo, Dec., Docket No. 8148, entered August 14, 1946). The burden of proof to show the incorrectness of the Franchise Tax Board's determination is upon the Appellant (Burnet v. Houston, 283 u. s. 223). Appellant having failed to present any evidence tending to show the determination to be arbitrary, improper or unreasonable, the action of the Franchise Tax Board as to this item must be sustained.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED pursuant to Section 25667 of the Revenue and Taxation Code (formerly Section 25(c) of the Bank and Corporation Franchise Tax Act) that the action of the Franchise Tax Board on the protests of The Times Mirror Company to proposed assessments of additional franchise tax in the amounts of $6,431.82, $7,896.11 and $4,812.88 for the income years 1943, 1944 and 1945, respectively, be and the same is hereby modified as follows: the income of The Times-Mirror Company for said years attributable to sources within California shall be adjusted by including in the out-of-state payroll factor salaries paid to its officersand employees while outside the State on business of The Times Mirror Company. In all other respects the action of the Franchise Tax Board is sustained.

Done at Los Angeles, California, this 27th day of October, 1953, by the State Board of Equalization.

Wm. G. Bonelli, Chairman

George R. Reilly, Member

J. H. Quinn, Member

Paul R. Leake, Member

Robert C. Kirkwood, Member

ATTEST: Dixwell L. Pierce, Secretary